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Testimony Concerning the Current State of Minority-Owned and Women-Owned Business Enterprises in the United States

Testimony of Jon S. Wainwright, Ph.D., Vice President, NERA Economic Consulting

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Chairman Kerry, Ranking Member Snowe, and Members of the Committee:

Thank you for the opportunity to appear here today. My name is Jon Wainwright. I hold a Ph.D. in economics from the University of Texas at Austin. Currently, I am a Vice President with National Economic Research Associates, also known as NERA Economic Consulting, in Chicago, Illinois and Austin, Texas.¹

Introduction

For almost twenty years, I have devoted the greater part of my professional life to studying race and sex discrimination and its impact on business enterprise and entrepreneurship in the United States.

I have served as the project director and principal investigator for 22 studies of business discrimination against minorities and women completed since 2000 and prior to that time on perhaps a dozen more.² I have authored a book on the subject and have provided expert testimony in federal and state courts on these and other labor and business related matters on 12 occasions.

I was fortunate to have been tutored at the start of my career by two of country's leading scholars in this field—Dr. Ray Marshall, Professor Emeritus at the Lyndon B. Johnson School of Public Affairs at The University of Texas at Austin and former United States Secretary of Labor, and Dr. Andrew Brimmer, former member of the Board of Governors of the Federal Reserve, former Assistant Secretary of Commerce, and Professor Emeritus at the University of Massachusetts, Amherst.

¹ NERA is an international firm of economists who understand how markets work. We provide economic analysis and advice to corporations, governments, law firms, regulatory agencies, trade associations, and international agencies. Our global team of more than 600 professionals operates in over 20 offices around the globe. Because of our commitment to deliver unbiased findings, we are widely recognized for our independence. Our clients come to us expecting integrity; they understand this sometimes calls for them to listen to unexpected or even unwelcome news. NERA's founding principles remain its guiding principles today: focus, independence, defensibility and clarity.

² Our recently completed disparity study for the City and County of Denver is available on the World Wide Web at the following address: <http://www.milehigh.com/business/do-business/CEI>. I will include the Executive Summary of this report in an appendix to this testimony. I also intend to include the complete text of our recently completed disparity study for the State of Maryland, since I cite it at several key points in my testimony.

A key lesson I absorbed from these men was expressed by Professor Marshall in this way:

“Institutionalized discrimination in business transactions is deeply rooted in the American economy. There can be no doubt that business discrimination inflicts serious damage on the society, polity, and economy. Governments have a responsibility to improve public understanding of the seriousness of this problem and to take positive steps to address it. These positive steps must include public education, specifically outlawing this form of discrimination, using governments’ purchasing power to help those who are being discriminated against while rewarding those who do not discriminate, and developing race neutral programs to help all small businesses.”³

If you accept that discrimination in business transactions is indeed deeply rooted in the American economy, then it is difficult to argue with the logic of Dr. Marshall’s conclusions.

During the last twenty years, the primary bulwark against business discrimination has been the policy of using public sector purchasing power to support the entrepreneurial endeavors of minority-owned and women-owned business enterprises (M/WBEs) and to promote fair and full access to government contracting and procurement opportunities. Programs such as 8(a) and 8(d) at the Small Business Administration, the Disadvantaged Business Enterprise (DBE) Program at the Department of Transportation, and the Small Disadvantaged Business (SDB) Program at the Defense Department’s are key examples of such policies at the federal level.

I would like to address myself today to the current state of M/WBEs in the United States, and the continuing need for affirmative public sector programs such as those of the SBA, the USDOT, and the USDOD. Before continuing, however, it is important to recognize the enormous amount of relevant evidence that already appears in the Congressional record. A useful synopsis of this evidence was provided by the Tenth Circuit Court of Appeals in their 2000 decision in *Adarand Constructors*.⁴

The disparities between minorities and Whites are much greater in business than they are in other economic activities, even though these other disparities remain considerable. The gap is particularly wide with respect to income and wealth. Currently, for example, African-Americans represented roughly 13 percent of the U.S. population, 12 percent of the civilian labor force, and 11 percent of total employment. However, African-

³ Ray Marshall, “Minority and Female Business Development After *Croson*,” Working Paper, 2000.

⁴ *Adarand Constructors, Inc. v. Slater*, 228 F.3d 1147, 1167-1175 (10th Cir. 2000) (discussing evidence before Congress of discrimination against minorities in the construction industry in enacting the Disadvantaged Business Enterprise Program for federal-aid transportation contracts, Pub.L. No. 100-17, 101 Stat. 132 (1987), Pub.L. No. 102-240, 105 Stat. 1914 (1991) and Pub.L. No. 105-178, 112 Stat. 107 (1998), and the implementing regulations at 49 CFR Part 26 (1999)).

Americans received only 7 percent of total money income, owned only 5 percent of the nation's businesses, and made only 1 percent of business sales.⁵

We create a many original and custom data sets in our research studies of M/WBEs. Your time is valuable and my time before you is limited, however, so I wish to briefly focus today on statistics from three or four important data sources, all produced within the federal government, that we utilize regularly in our research. These are the *Survey of Business Owners* (SBO) and the *Public Use Microdata Sample* (PUMS) from the decennial census, both produced by the Census Bureau, the *Current Population Surveys* (CPS), produced jointly by the Census Bureau and the Bureau of Labor Statistics, and the *Survey of Small Business Finances* (SSBF) produced by the Federal Reserve Board and the SBA. These are the key publicly available data sources that are able to shed light on the state of MWBEs. In the interest of time, I also limit my discussion primarily to African Americans and Hispanics and Latinos, our two largest minority groups.

Survey of Business Owners

The most recent SBO data from 2002 counted just under 22.5 million privately held business enterprises in the United States in 2002. Those firms, in total, made 8.78 trillion in sales and receipts, or almost \$391,000 per firm on average.

Large disparities are observed in the SBO between the share of minorities in the general population and their share of the business population.

- Although African Americans comprised 12.7 percent of the U.S. population in 2002, they accounted for only 5.3 percent of its businesses
- Although Hispanics and Latinos comprised 13.4 percent of the population, they accounted for only 7.0 percent of the businesses
- Although women comprised 50.9 percent of the population, they accounted for only 28.9 percent of the businesses.

More troubling still, there are large disparities between the minority and female share of the business population and their share of business sales and receipts.

- Although African Americans comprised 5.3 percent of all U.S. businesses in 2002, they earned only 1.0 percent of sales and receipts.
- Although Hispanics and Latinos comprised 7.0 percent of all businesses, they earned only 2.5 percent of sales and receipts.
- Although women comprised 28.9 percent of all businesses, they earned only 10.7 percent of sales and receipts.⁶

⁵ Bureau of the Census, *Statistical Abstract of the United States: 2006*, various tables, and *Survey of Business Owners: 2002*. A similar pattern is evident for Hispanics, as well as for other racial or ethnic minorities, with the exception of certain Asian ethnic groups.

These disparities between the size of the minority and female business populations and their share of sales and receipts are very large. They are also statistically significant, meaning they are unlikely to have arisen by chance.

While the exact proportions vary, the large and statistically significant disparities are observed in all 50 states and the District of Columbia, for all minority groups as well as for women. When the results are disaggregated by industry sector, again, the specific proportions vary but the overall trend is one of large and statistically significant disparities. Similar outcomes have been observed in all prior versions of this survey, dating back to 1972.

Decennial Census Public Use Microdata Sample and Current Population Survey Data

It is a fair question to ask whether such disparities result primarily from discrimination, either past, present or both, or whether they arise primarily due to other, non-discriminatory, factors.⁷ The evidence strongly suggests they arise primarily as a result of discrimination.

I have tested this hypothesis empirically using microdata from the 2000 decennial census, and earlier from the 1990 census. Like the SBO, these data sources document large and statistically significant disparities between the proportion of business owners who are minorities or women and their share of business owner earnings, in the nation as a whole, and throughout the states, and in the economy as a whole as well as across different industry sectors.

The advantage of the PUMS is that it allows us to compare these percentages while holding a wide variety of other, potentially non-discriminatory factors, constant, including industry, geography, education, age, and labor market status, among other factors.⁸ Even when all these factors are held constant, using a statistical technique known as regression analysis, the disparities facing minority and women business owners remain large and statistically significant.

The disadvantage of PUMS is that it is only produced once every ten years. In the interim, data from the CPS are available annually through 2006. The CPS is the source of official government statistics on employment and unemployment and has been conducted monthly for over 40 years. The data structure of the CPS is similar to the decennial census, so it is possible to conduct similar types of disparity analyses to those I have just described. When this is done, the results again show large and statistically significant

⁶ Similar disparities are observed for other minority groups in the SBO. Asians and Pacific Islanders comprised 5.0 percent of the business population yet earned only 3.8 percent of sales and receipts. Native Americans comprised 0.9 percent of all businesses but earned only 0.3 percent of sales and receipts.

⁷ This was the subject of my book, *Racial Discrimination and Minority Business Enterprise: Evidence from the 1990 Census*, New York and London: Garland Publishing, 2000. Similar findings are observed using the 2000 decennial census data. See, e.g. NERA Economic Consulting, "Race, Sex, and Business Enterprise: Evidence from the State of Maryland (Final Report)", 8 March 2006, 107-145.

⁸ We have also tested the hypothesis, with similar results, including additional factors such marital and family status, immigration status, ability to speak English, military service, disability status, and asset levels.

disparities facing minority and women business owners, even when a large variety of potentially non-discriminatory factors is held constant.⁹

Survey of Small Business Finances

Lack of access to capital and credit is among the most frequently cited obstacles to success among MWBEs, particularly African-Americans and Hispanics and Latinos.¹⁰ It is also reported more frequently by women business owners than by men. Discrimination in the credit market against such businesses can obviously have an important effect on the likelihood that they will succeed. Indeed, discrimination in the credit market could even prevent such businesses from opening in the first place.

Data from the Federal Reserve Board allow us to test for evidence of discrimination in the small business credit market in recent years. The SSBF data are based on a large representative sample of firms with fewer than 500 employees and are administered by the Federal Reserve Board and the U.S. Small Business Administration. We have analyzed data from the three most recent releases of this data series, in 1993, 1998, and 2003.

The beauty of the SSBF data is that, in addition to the race and sex of the business owners, it contains complete balance sheet and credit history information for each businesses that was interviewed. This is the same information that would be available to a loan officer when making a determination of whether or not to grant credit. With this data, we can use regression analysis to test for race and sex disparities in access to commercial credit while holding constant all of the relevant balance sheet and credit history information.

These data provide qualitative and quantitative evidence consistent with the presence of discrimination against minorities in the credit market for small businesses. After controlling for a large number of balance sheet, credit history, and other characteristics, we find that African American-owned firms and other minority-owned firms are substantially and statistically significantly more likely to be denied credit than are White-owned firms. We also find some evidence that women are discriminated against in this market as well. The principal results are as follows:

- Minority-owned firms were more likely to report that they did not apply for a loan over the preceding three years because they feared the loan would be denied.
- When minority-owned firms did apply for a loan their loan requests were substantially more likely to be denied than non-minorities, even when balance sheets and credit history differences were accounted for.
- When minority-owned firms did receive a loan they were obligated to pay higher interest rates on the loans than was true of comparable White-owned firms.

⁹ See, e.g., NERA Economic Consulting, *op. cit.*, 107-145.

¹⁰ See, e.g., U.S. Chamber of Commerce (2005), "Access to capital, what funding sources work for you?", U.S. Chamber of Commerce, Washington, DC, 55.

- Far more minority-owned firms report that credit market conditions are a serious concern than do White-owned firms.
- A greater share of minority-owned firms believes that the availability of credit is the most important issue likely to confront their firms in the upcoming year.
- There is no evidence that discrimination in the market for credit is significantly different in different regions of the US, or in certain industries versus the economy as a whole.
- There is no evidence that the level of discrimination in the market for credit has diminished during the 1990s or the 2000s.¹¹

Anecdotal Evidence of Discrimination

In addition to the statistical evidence of discrimination the numerous studies we have conducted in recent years found extensive anecdotal evidence of discrimination against minorities and women in the construction and construction-related professional services. In conjunction with my long time colleague, attorney Colette Holt of Colette Holt & Associates in Chicago, we have conducted surveys of and in person interviews with hundreds of M/WBEs and majority-male owned firms, and the results are strikingly similar across the country.

In general, minorities and women reported that they still encounter significant barriers to doing business in the public and private sector market places, as both prime contractors and subcontractors. They often suffer from stereotypes about their suspected lack of competence and are subject to higher performance standards than similar White men. They also encounter discrimination in obtaining loans and surety bonds; receiving price quotes from suppliers; working with trade unions; obtaining public and private sector prime contracts and subcontracts, and being paid promptly. Finally, there was general agreement that without the use of affirmative action remedies such as subcontracting goals, minorities and women would receive few if any opportunities on government contracts, as is the case on non-goals projects. Prime contractors that solicit M/WBEs on goals projects rarely do so in the absence of goals. Thus, the continued operation of programs such as the SBA 8(a) and 8(d) programs was deemed essential to M/WBEs' survival.

Conclusion

It is fairly easy to specify in a general way the economic consequences of such programs. They have improved economic opportunities for minorities and women in business and therefore improved the competitiveness and efficiency of the American economy. They have also focused public attention on discrimination against minority and female businesses for reasons unrelated to qualifications or performance.

¹¹ See, e.g., NERA Economic Consulting, *op. cit.*, 147-200. See also, NERA Economic Consulting, "Race, Sex, and Business Enterprise: Evidence from Austin, Texas," forthcoming 2007, which includes results from the 2003 SSBF.

These public sector programs, standing alone, will not solve the problem of business discrimination. The private sector, which is far larger in terms of economic activity and scope, must take on more responsibility for eliminating business discrimination as well. Some major corporations have begun to take important steps down this road by developing genuine supplier diversity initiatives, but these companies are the exception rather than the rule.

I am optimistic that the statistical and anecdotal evidence will one day show that programs such as 8(a) and 8(d) are no longer necessary, because minority-owned and women-owned businesses have achieved competitive parity with their majority-owned counterparts. However, my own research and that of my colleagues demonstrates that this day has not yet arrived.

Thank you.